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Q1FY20 result review  
and earnings revision

## Capital Goods

Target price: Rs710

### Earnings revision

(%)	FY20E	FY21E
Sales	↓ 6.2	↓ 6.4
EBITDA	↓ 18.9	↓ 12.5
PAT	↓ 17.4	↓ 12.2

### Target price revision

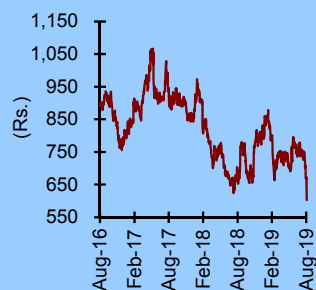
Rs710 from Rs889

### Shareholding pattern

	Dec '18	Mar '19	Jun '19
Promoters	51.0	51.0	51.0
Institutional investors	36.0	36.0	36.7
MFs and others	17.8	20.4	21.1
FIs/Banks/Ins	6.7	6.3	6.4
FII	11.5	9.3	9.2
Others	13.0	13.0	12.3

Source: NSE

### Price chart



## Cummins India

**BUY**

**Maintained**

Margin pressure and weak exports impact earnings

**Rs603**

Cummins India (Cummins) has posted one of the lowest quarterly margins at 11.3% (down 490 bps YoY) impacted by adverse product mix and 100bps drop due to forex under material cost. Given the weak outlook in exports, the management cuts export guidance sharply and marginally cuts domestic guidance. Though the outlook is challenging, we believe, the operations have touched a nadir. Focus on new products, CPCB norm change etc will open up medium- to long-term growth prospects. We believe the company will be able to tide over these turbulent times. We maintain our BUY rating with a revised target price of Rs710 (earlier: Rs889).

- ▶ **Weak exports continue to hamper growth prospects:** Export demand has been impacted majorly by the Middle East, Africa and Latin American geographies resulting in 26% YoY decline. Under export, the major impact has been 46% YoY drop in MidRange segment at Rs800mn and 40% YoY decline in LHP segment at Rs500mn. Given the challenging scenario, the export growth is expected to be muted in the near to medium term.
- ▶ **Stable growth from domestic powergen:** Driven by data centre application, infrastructure and commercial realty, the domestic powergen grew 8% YoY to Rs4bn, majorly driven by 11% YoY growth under HHP at Rs2.1bn. While the MHP segment growth declined by 8% YoY to Rs1.1bn.
- ▶ **Margin impact due to adverse product mix and forex fluctuation:** Material cost proportion to sales increased by 330bps YoY to 66%, this is largely due to the change in product mix. It was also impacted by ~100bps due to adverse forex movement. Last year in H1FY20, the company also had certain benefits in terms of forex. Around 2-3% price hike has limited the forex decline by 50 bps YoY.
- ▶ **Strong industrial segment growth, expect the run rate to continue:** Industrial segment grew 35% YoY over a low base supported by 70% growth under railways and 125% growth under compressor segment. Though outlook under construction is weak, railways and compressors are expected to witness healthy growth.
- ▶ **Maintain BUY on medium- to long-term recovery:** Focus on market share, enhancing the overall offerings and introduction of innovative solutions continue to be the company's hallmark. We believe margins have bottomed out; however, given the near-term risk in terms of weak exports and the overall challenges in margins cut earnings by 17% and 12% for FY20/21E, respectively. We factor-in gradual improvement in margins and expect exports to recover in FY21E, long-term growth potential is intact with the introduction of CPCB IV.

Market Cap	Rs167bn/US\$2.4bn	Year to Mar (Std)	FY18	FY19	FY20E	FY21E
Reuters/Bloomberg	CUMM.BO/KKC IN	Revenue (Rs mn)	51,611	56,590	57,710	64,344
Shares Outstanding (mn)	277.2	Net Income (Rs mn)	6,692	7,226	6,391	7,658
52-week Range (Rs)	878/603	DEPS (Rs)	24.1	26.1	23.1	27.6
Free Float (%)	49.0	% Chg YoY	(8.9)	8.0	(11.5)	19.8
FII (%)	9.2	P/E (x)	25.1	23.2	26.2	21.9
Daily Volume (US\$/'000)	5,086	CEPS (Rs)	28.9	30.0	27.2	32.0
Absolute Return 3m (%)	(12.6)	EV/E (x)	21.9	18.6	20.9	16.8
Absolute Return 12m (%)	(9.1)	Dividend Yield (%)	2.5	2.8	2.6	2.6
Sensex Return 3m (%)	(0.5)	RoCE (%)	21.0	23.8	20.5	23.6
Sensex Return 12m (%)	(0.2)	RoE (%)	17.3	17.8	15.3	17.5

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## Valuation and outlook

We expect domestic market to witness gradual revival in demand, driven by data centres (where Cummins holds highest market share) along with infrastructure, railways and manufacturing growth. The company has recently taken price hikes; hence, the gross margin is expected to stabilise. Near-term growth will be impacted due to weak exports, which we believe, will bounce back in FY21E.

Taking account of higher other income due to lease rentals and high cash position, for our valuation methodology, we value core earnings separately, lease rental income separately and adding back the cash adjusted for the dividend tax. We value core earnings at 14% discount to 1-year forward mean at 25x FY21E core earnings, discount the lease rentals @8% for 10 years and add back the cash post accounting for dividend tax. This works out to a target price of Rs710 (table 2).

**Table 1: Earnings revision**

(Rs mn)

	FY20E			FY21E		
	Previous	Revised	% chg	Previous	Revised	% chg
Revenues	61,506	57,710	(6.2)	68,723	64,344	(6.4)
EBITDA	9,461	7,671	(18.9)	10,892	9,534	(12.5)
PAT	7,737	6,391	(17.4)	8,719	7,658	(12.2)

Source: Company data, I-Sec research

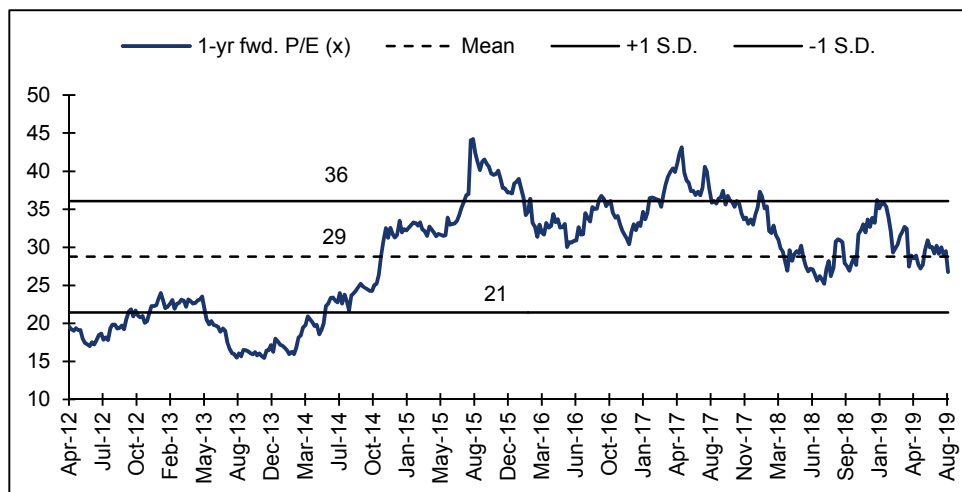
**Table 2: Valuation summary**

(Rs mn)

	FY18	FY19	FY20E	FY21E
PAT	6,692	7,226	6,391	7,658
tax rate (%)	22.0	29.9	31.0	31.0
Interest income	472	561	700	700
Rental Income	832	1,174	1,170	1,200
Operating PAT	5,676	6,008	5,101	6,347
PE (x)				25
Value				1,58,667
Cash & Cash Equivalent (excl DDT)				10,322
DDT on cash (@20.36%)				2,102
Discounted Lease contribution				5,617
Gross value				1,72,504
<b>Cummins Standalone value per share (Rs) (A)</b>				<b>622</b>
Vavoline FY21 PAT				1,625
FY21 PE multiple (x)				30
Valvoline Gross value				48,735
Holding value (50% stake)				24,368
<b>Valvoline value per share (Rs) (B)</b>				<b>88</b>
<b>Total value per share (Rs) (A+B)</b>				<b>710</b>

Source: Company data, I-Sec research

Chart 1: 1-year forward P/E chart



Source: Company data, I-Sec research

Table 3: Result highlights

(Rs mn)

	Q1FY19	Q1FY20	YoY(%)	Q4FY19	QoQ(%)	Isec est	Var(%)
<b>Total Revenue</b>	13,280	13,430	1.1	13,404	0.2	13,703	(2.0)
EBITDA	2,147	1,514	(29.5)	1,718	(11.9)	2,071	(26.9)
Margin	16.2	11.3	-489bps	12.8	-155bps	15.1	-384bps
Depreciation	271	291	7.5	280	3.9	281	3.3
Finance Cost	36	52	45.8	45	14.8	35	48.8
Other Income	696	769	10.5	692	11.1	1,009	(23.8)
Extraordinary income	-	-	-	-	-	-	-
PBT	2,536	1,940	(23.5)	2,085	(6.9)	2,763	(29.8)
Tax	706	525	(25.6)	676	(22.3)	829	(36.6)
tax rate	27.8	27.1	-77bps	32.4	-535bps	30.0	-293bps
Reported PAT	1,830	1,415	(22.7)	1,409	0.4	1,934	(26.8)
<b>Adjusted PAT</b>	1,830	1,415	(22.7)	1,409	0.4	1,934	(26.8)
Margin (%)	13.8	10.5	-324bps	10.5	2bps	14.1	-358bps
EPS (Rs)	6.6	5.1	-	5.1	-	7.0	-

Source: Company data, I-Sec research

**Table 4: Quarterly segmental trend**

<i>(Rs mn)</i>	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	YoY (%)
<b>Revenues</b>						
Powergen	3,600	4,100	4,300	4,000	3,930	9.2
Distribution	3,200	3,500	3,500	3,300	3,460	8.1
Industrial	1,800	2,400	2,500	2,700	2,500	38.9
<b>Domestic</b>	<b>8,555</b>	<b>10,036</b>	<b>10,223</b>	<b>9,917</b>	<b>9,893</b>	<b>15.6</b>
% YoY	-4%	34%	14%	20%	16%	20bps
<b>Exports</b>	<b>4,410</b>	<b>4,480</b>	<b>4,410</b>	<b>3,227</b>	<b>3,270</b>	<b>(25.9)</b>
% YoY	10%	21%	5%	-17%	-26%	-36bps
<b>Total</b>	<b>12,965</b>	<b>14,516</b>	<b>14,633</b>	<b>13,144</b>	<b>13,163</b>	<b>1.5</b>
<b>Powergen Domestic</b>						
LHP (till 62.5kva)	400	400	400	800	450	12.5
MHP (82.5-250kva)	1200	1200	1250	1200	1100	-8.3
Heavy Duty (320-380kva)	210	300	200	100	350	66.7
HHP (500kva+)	1942.5	2200	2300	1900	2150	10.7
<b>Total</b>	<b>3752.5</b>	<b>4100</b>	<b>4150</b>	<b>4000</b>	<b>4050</b>	<b>7.9</b>
<b>Industrial Segment</b>						
Compressors	200	100	200	500	450	125.0
Construction	950	1000	1100	1100	900	-5.3
Mining	100	100	200	150	100	0.0
Rail	500	1000	700	800	850	70.0
Others	100	200	300	150	200	100.0
<b>Total</b>	<b>1850</b>	<b>2400</b>	<b>2500</b>	<b>2700</b>	<b>2500</b>	<b>35.1</b>
<b>Exports</b>						
LHP	840	700	800	500	500	-40.5
Midrange	1470	1300	1300	800	800	-45.6
Heavy duty	300	300	330	300	300	0.0
HHP	1600	2000	1900	1400	1400	-12.5
spare parts	400	150	150	220	250	-37.5
<b>Total</b>	<b>4610</b>	<b>4450</b>	<b>4480</b>	<b>3220</b>	<b>3250</b>	<b>-29.5</b>

Source: Company data, I-Sec research

## Key concall takeaways:

- Management reduced export segment guidance for FY20 to -10% to -15% from flat to negative growth earlier and expressed pessimism around exports given the softness in overseas markets. However, the management reduced the domestic sales guidance to 8-10% from 10-15% given the near-term headwinds in the infrastructure space.
- Gross margins declined 3.3% YoY to 34% as contribution from high margin exports declined in the overall mix and there was a forex impact of ~100bps in the material cost as proportion of sales. However, ~2-3% price hike taken in the last quarter supported Q1FY20 margins by 50bps.
- In the industrial segment, the management shared concerns on the mining industry. While compressors and railways are expected to do well, construction is seen flat for FY20.
- Revenue from Middle East declined 30-40% YoY and the geography contributed Rs500mn in Q1FY20.
- The company shares optimism around the benefit to Cummins Generator Technologies India (CGT) from movement of trade from China to India in relation to the ongoing trade war and mentioned it will be closely monitoring the developments.
- New products are likely to create new market with some products (unclear), while margin improvement or market share increase in some cases.
- As the LHP mix increases and high-margin exports decline in FY20, overall gross margins are expected to be under pressure for FY20. However, the company shared info on its efforts to offset the pressure by improving the cost structure in the domestic market.

**Table 5: Key assumptions**

(Rs mn).

	FY16	FY17	FY18	FY19	FY20E	FY21E
PowerGen	12,500	13,540	13,946	16,000	16,640	18,637
% YoY	18.5	8.3	3.0	14.7	4.0	12.0
Distribution	9,850	11,500	12,620	13,500	14,445	15,890
% YoY	6.5	16.8	9.7	7.0	7.0	10.0
Industrial	5,600	7,160	7,730	9,230	10,615	12,207
% YoY	9.8	27.9	8.0	19.4	15.0	15.0
<b>Domestic</b>	<b>33,192</b>	<b>37,114</b>	<b>34,296</b>	<b>38,730</b>	<b>41,700</b>	<b>46,733</b>
% YoY	14.4	11.8	(7.6)	12.9	7.7	12.1
<b>Exports</b>	<b>16,476</b>	<b>15,981</b>	<b>16,007</b>	<b>16,527</b>	<b>14,544</b>	<b>15,998</b>
% YoY	(4.3)	(3.0)	0.2	3.2	(12.0)	10.0
<b>Total</b>	<b>49,668</b>	<b>53,095</b>	<b>50,303</b>	<b>55,257</b>	<b>56,243</b>	<b>62,731</b>

Source: Company data, I-Sec research

## Financial summary

Table 6: Profit &amp; loss statement

(Rs mn, year ending March 31)

	FY18	FY19	FY20E	FY21E
<b>Total Income</b>	<b>51,611</b>	<b>56,590</b>	<b>57,710</b>	<b>64,344</b>
<b>Operating Expenses</b>	<b>44,286</b>	<b>47,949</b>	<b>50,038</b>	<b>54,810</b>
<b>EBITDA</b>	<b>7,325</b>	<b>8,641</b>	<b>7,671</b>	<b>9,534</b>
% margins	14.2	15.3	13.3	14.8
Depreciation & Amortisation	938	1,103	1,158	1,216
<b>EBIT</b>	<b>6,387</b>	<b>7,538</b>	<b>6,513</b>	<b>8,318</b>
Gross Interest	148	162	150	150
Other Income	2,285	2,928	2,900	2,930
<b>PBT before exceptionals</b>	<b>8,523</b>	<b>10,304</b>	<b>9,263</b>	<b>11,098</b>
Add:				
Extraordinaries/Exceptionals	561	-	-	-
Add: Share in associates				
<b>PBT</b>	<b>9,084</b>	<b>10,304</b>	<b>9,263</b>	<b>11,098</b>
Less: Taxes	2,000	3,078	2,871	3,440
Less: Minority Interests				
<b>Net Income (Reported)</b>	<b>7,085</b>	<b>7,226</b>	<b>6,391</b>	<b>7,658</b>
<b>Adjusted Net Income</b>	<b>6,692</b>	<b>7,226</b>	<b>6,391</b>	<b>7,658</b>

Source: Company data, I-Sec research

Table 7: Balance sheet

(Rs mn, year ending March 31)

	FY18	FY19	FY20E	FY21E
<b>Assets</b>				
Total Current Assets	32,095	34,081	33,447	35,942
of which cash & cash eqv.	9,769	9,807	10,469	10,322
Total Current Liabilities & Provisions	12,637	13,152	13,377	14,794
<b>Net Current Assets</b>	<b>19,458</b>	<b>20,929</b>	<b>20,070</b>	<b>21,148</b>
Investments	7,738	7,706	7,706	7,706
Other Non-Current Assets	2,219	2,316	2,376	2,439
<b>Net Fixed Assets</b>	<b>13,261</b>	<b>14,433</b>	<b>16,389</b>	<b>17,673</b>
Goodwill				
<b>Total Assets</b>	<b>42,675</b>	<b>45,384</b>	<b>46,541</b>	<b>48,966</b>
<b>Liabilities</b>				
Borrowings	2,515	3,092	3,092	3,092
Deferred Tax Liability	299	988	988	988
Minority Interest				
Equity Share Capital	554	554	554	554
Face Value per share (Rs)	2.00	2.00	2.00	2.00
Reserves & Surplus	39,306	40,750	41,908	44,332
<b>Net Worth</b>	<b>39,861</b>	<b>41,305</b>	<b>42,462</b>	<b>44,886</b>
<b>Total Liabilities</b>	<b>42,675</b>	<b>45,384</b>	<b>46,541</b>	<b>48,966</b>

Source: Company data, I-Sec research

Table 8: Cashflow statement

(Rs mn, year ending March 31)

	FY18	FY19	FY20E	FY21E
<b>Operating Cashflow</b>	<b>5,735</b>	<b>6,991</b>	<b>7,700</b>	<b>9,024</b>
Working Capital Changes	49	(1,532)	1,461	(1,287)
Capital Commitments	(527)	(1,685)	(3,115)	(2,500)
<b>Free Cashflow</b>	<b>5,256</b>	<b>3,775</b>	<b>6,046</b>	<b>5,237</b>
<b>Cashflow from Investing</b>				
<b>Activities</b>	<b>(800)</b>	<b>1,854</b>	<b>(485)</b>	<b>(583)</b>
Issue of Share Capital				
Buyback of shares				
Inc (Dec) in Borrowings	8	576	-	-
Interest paid	148	162	150	150
Dividend paid	(4,906)	(5,561)	(5,234)	(5,234)
<b>Extraordinary Items/Others</b>	<b>2,140</b>	<b>(769)</b>	<b>185</b>	<b>283</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>1,845</b>	<b>38</b>	<b>662</b>	<b>(147)</b>

Source: Company data, I-Sec research

Table 9: Key ratios

(Year ending March 31)

	FY18	FY19	FY20E	FY21E
<b>Per Share Data (in Rs.)</b>				
Diluted adjusted EPS	24.1	26.1	23.1	27.6
Recurring Cash EPS	28.9	30.0	27.2	32.0
Dividend per share (DPS)	15.0	17.0	16.0	16.0
Book Value per share (BV)	143.8	149.0	153.2	161.9
<b>Growth Ratios (%)</b>				
Operating Income	1.6	9.6	2.0	11.5
EBITDA	(8.6)	18.0	(11.2)	24.3
Recurring Net Income	(8.9)	8.0	(11.5)	19.8
Diluted adjusted EPS	(8.9)	8.0	(11.5)	19.8
Diluted Recurring CEPS	(2.1)	3.8	(9.4)	17.5
<b>Valuation Ratios</b>				
P/E	25.1	23.2	26.2	21.9
P/CEPS	20.9	20.1	22.2	18.9
P/BV	4.2	4.1	3.9	3.7
EV / EBITDA	21.9	18.6	20.9	16.8
EV / Operating Income	3.1	2.8	2.8	2.5
EV / Operating FCF (pre -Capex)	27.7	29.5	17.5	20.7
<b>Operating Ratios</b>				
Raw Material/Sales (%)	63.1	63.9	65.0	64.2
SG&A/Sales (%)	11.5	9.8	10.1	9.5
Other Income / PBT (%)	26.8	28.4	31.3	26.4
Effective Tax Rate (%)	23.5	29.9	31.0	31.0
NWC / Total Assets (%)	21.5	23.0	20.0	20.8
Inventory Turnover (days)	39.0	41.3	41.4	41.4
Receivables (days)	93.8	82.1	80.0	80.0
Payables (days)	53.6	53.2	53.2	53.2
Net D/E Ratio (x)	(0.2)	(0.2)	(0.2)	(0.2)
<b>Return/Profitability Ratios (%)</b>				
Recurring Net Income Margins	13.0	12.8	11.1	11.9
RoCE	21.0	23.8	20.5	23.6
RoNW	17.3	17.8	15.3	17.5
Dividend Payout Ratio	62.1	65.2	69.4	57.9
Dividend Yield (%)	2.5	2.8	2.6	2.6
EBITDA Margins	14.2	15.3	13.3	14.8

Source: Company data, I-Sec research

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